

Message Text

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ACTION ARA-20

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E.O. 11652: GDS

SUBJECT: GOC BUDGET CUTS/AID STRATEGY

SUMMARY

THE GOC IS UNDERTAKING A MAJOR EFFORT TO PUT ITS FISCAL AND MONETARY HOUSE IN ORDER BY REDUCING GOVERNMENT EXPENDITURES AND INCREASING REVENUE COLLECTIONS. IN THE MEDIUM TERM, A COMPREHENSIVE TAX REFORM PACKAGE, EXPECTED TO BE PRESENTED TO CONGRESS SHORTLY, MAY PROVIDE THE

RESOURCES NECESSARY TO CONTINUE A HIGH LEVEL OF INVESTMENT IN THE SOCIAL SECTORS, BUT THE SHORT-TERM IMPLICATION OF THE AUSTERITY PROGRAM IS THAT HEAVY CUTS MUST BE MADE IN THE INVESTMENT BUDGET, WHICH IS

LARGELY CONCENTRATED IN THE SOCIAL SECTORS. THIS IS LIKELY TO RESULT IN A SHORTFALL IN GOC COUNTERPART FOR AID SECTOR LOANS AND REQUESTS BY THE GOC FOR REDUCTIONS IN COUNTERPART REQUIREMENTS.

1. THE BUDGET CUTS

THE GOC VIEWS AS ITS HIGHEST IMMEDIATE DOMESTIC PRIORITY AN ANTI-INFLATIONARY CAMPAIGN, REQUIRING A SEVERE DECLINE IN PUBLIC SECTOR EXPENDITURES. OUR BEST ESTIMATE OF THEIR CURRENT FISCAL SITUATION IS LIMITED OFFICIAL USE

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THAT ELIMINATION OF THE 1974-75 BUDGET DEFICIT-A GOC GOAL-WILL

NECESSITATE A CUT OF 30 PERCENT - 40 PERCENT IN THE 1974 INVESTMENT BUDGET, COMBINED WITH STAGNATION IN REAL TERMS IN 1975. THE BUDGET PROBLEM HAS BEEN CAUSED IN LARGE PART BY STAGNANT OR DECLINING TAX REVENUES (IN REAL TERMS) OVER THE PAST SEVERAL YEARS. HIGH ADMINISTRATION OFFICIALS, BEGINNING WITH PRESIDENT LOPEZ AND MINFIN BOTERO, HAVE REPEATEDLY STRESSED THE SERIOUSNESS OF THIS PROBLEM AND THEIR INTENT TO TAKE IMMEDIATE STEPS THROUGH IMPROVED TAX ADMINISTRATION AND A TAX REFORM PACKAGE TO BE SUBMITTED TO THE CONGRESS IN OCTOBER.

2. UNFORTUNATELY LITTLE OR NO REVENUE IMPROVEMENT CAN BE EXPECTED IN 1974, AND THE 1975 IMPACT WILL DEPEND HEAVILY ON HOW QUICKLY CONGRESSIONAL ACTION ON THE TAX REFORMS CAN BE OBTAINED. IN THE INTERIM, THE GOC WILL BE FACED WITH THE NEED TO MAKE DEEP CUTS IN THE INVESTMENT BUDGET, ADVERSLY AFFECTING KEY GOC SOCIAL DEVELOPMENT PROGRAMS IN HEALTH, AGRICULTURE AND EDUCATION. OUT OF THE 11 BILLION PESOS CURRENTLY IN THE 1974 INVESTMENT BUDGET (EXCLUDING TRANSFERS TO REGIONAL GOVERNMENTS) THE GOC PLANS TO CUT AT LEAST 4 BILLION. SINCE AT LEAST 6 OF THE 11 BILLION PESOS ARE DIRECTLY RELATED TO THE SOCIAL SECTORS OF HEALTH, EDUCATION AND AGRICULTURE, JOINT USAID/GOC PRIORITY DEVELOPMENT PROGRAMS ARE LIKELY TO SUFFER IN THIS INTERIM PERIOD.

3. SHORT TERM AID STRATEGY

THE STRATEGY IMPLICIT IN THE SECTOR LOAN CONCEPT OF LEVERING UP GOC INVESTMENT IN THE SOCIAL SECTORS THROUGH A DECLINING AID SHARE OF AN INCREASING TOTAL BUDGET, IS IMPRACTICAL IN THE NEAR FUTURE. GOC COUNTERPART REQUIREMENTS HAVE ALREADY BEEN LEVERED UP BEYOND THEIR BUDGETARY CAPABILITIES. THE GOC ECONOMIC TEAM IS NOW IN THE PROCESS OF ANALYZING AND REVISING THE 1974 AND 1975 BUDGETS. THE REDUCTION IN INVESTMENT BUDGET LEVEL MAY WELL MEAN COMPARABLE REDUCTIONS IN PLANNED AID SECTOR LOAN DISBURSEMENTS. WE ANTICIPATE THAT THE GOC WILL REQUEST MODIFICATION IN DISBURSEMENT RATIOS AND/OR EXTENSION

OF LOAN TERMINAL DISBURSEMENT DATES. WE OF COURSE HAVE NO SUCH REQUEST

AS YET AND NO IMMEDIATE DECISION IS CALLED FOR. IN ANY CASE, WE FEEL THAT ANY DECISION REGARDING ANY REQUEST FOR CHANGES IN COUNTERPART REQUIREMENTS SHOULD COME ONLY AFTER THE GOC HAS PRESENTED ITS TAX PACKAGE TO CONGRESS, AND HAS INDICATED ITS LIMITED OFFICIAL USE

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INTENTION REGARDING WHICH PROGRAMS ARE TO BE CUT AND WHICH ARE TO BE MAINTAINED INTACT.

WE WILL KEEP WASHINGTON INFORMED OF DEVELOPMENTS IN THIS AREA.
VAKY

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